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DIRECTORATE OF
INTELLIGENCE

Intelligence Memorandum

Malaysia: Economic Prospects And Racial Discord

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CENTRAL INTELLIGENCE AGENCY
Directorate of Intelligence
July 1971

INTELLIGENCE MEMORANDUM

MALAYSIA: ECONOMIC PROSPECTS AND RACIAL DISCORD

Introduction

1. The outbreak of racial violence in Kuala Lumpur in May 1969 threatened to upset Malaysia's tenuously balanced interracial political system and its considerable economic achievements. With the riots the grievances of the relatively poor, largely rural Malays against the relatively well-off, largely urban Chinese became a readily exploitable political issue. The more radical Malay political groups quickly surfaced their demands for rapidly overcoming racial economic disparities. Essentially, these demands have called for wider Malay participation in the modern sectors of the economy at the expense of the Chinese. They have implied, furthermore, massive government intervention and subsidization which would be a sharp departure from the traditional free enterprise system.

2. The previous, 13-year administration of the Tunku Abdul Rahman was reluctant to imperil economic efficiency and investor confidence by capitulating to more extreme Malay demands. How the fledgling Razak administration, which assumed formal power only in September 1970, ultimately responds to the pressures of these demands will greatly influence Malaysia's future. This memorandum analyzes the factors underlying Malaysia's past economic achievements, assesses the present economic positions of the Malays and the Chinese, and evaluates the prospects for continuity in economic policies and for continued economic growth.

Discussion

Malaysia's Unique Achievements

3. Malaysia is an outstanding example of a less developed country achieving sustained economic growth as a primary commodity exporter.

Note: This memorandum was prepared by the Office of Economic Research and coordinated within the Directorate of Intelligence.

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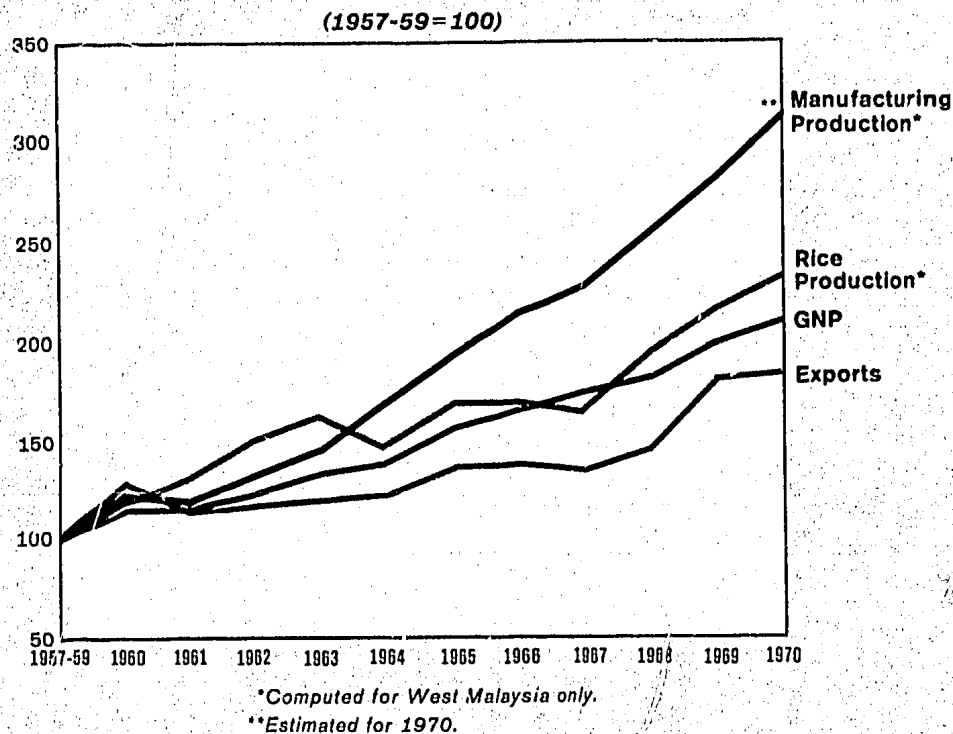
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Whereas many other countries have remained dependent on a single crop or mineral export and experienced very slow or stagnating economic growth, Malaysia has boosted trade earnings and national output by introducing new export products. It has also made substantial gains in developing import substitution industries. During the 1960s, GNP grew 7% annually (see Figure 1), reaching \$3.9 billion in 1970. ^{1/} Although population also has grown rapidly – at more than 3% per year – per capita GNP has risen steadily and now stands at about \$360, topped in Southeast Asia only by the city-state of Singapore and the small, oil-rich sultanate of Brunei.

MALAYSIA: Selected Economic Indicators

Figure 1



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1. All dollar figures in this memorandum are in US dollars.

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4. One of the most prosperous, efficient, and well-run economies in the less developed world, Malaysia has been largely self-reliant in its development while maintaining a strong balance of payments and a non-inflationary domestic economy. Official aid has been relatively unimportant and the government has borrowed mostly from domestic sources. Service payments on official external debt currently run at a small 3% of annual exports.

5. The colonial "open" system of international trade and payments, retained after independence from the United Kingdom in 1957, has worked quite well. Import barriers are few for a less developed country, capital movements are virtually unrestricted, and the domestic currency is fully backed by official international reserves. These amounted to over \$800 million at the end of 1970, enough to finance about seven months' imports. Large reserves have been maintained under the open system partly because incomes are highly dependent on exports, and imports tend to adjust automatically to export trends (see Figure 2). In addition the price level is heavily influenced by the availability of imports. The consumer price index in Malaysia rose by less than 1% a year between 1960 and 1970.

6. In no small measure, sustained economic growth and stability have been possible because of political stability. Although tensions have sometimes been acute between the politically dominant Malays and the economically dominant Chinese, such difficulties have not adversely affected Malaysia's economy. The private enterprise system has been left virtually undisturbed, and extensive official investment incentive programs have bolstered investor confidence. The economy has continued to run smoothly and efficiently through such crises as the break with Singapore, the confrontation with Indonesia, and even the May 1969 racial riots. Private investment did fall slightly in 1969 probably because of the May disturbances, but in 1970 it rose by a substantial 33%.

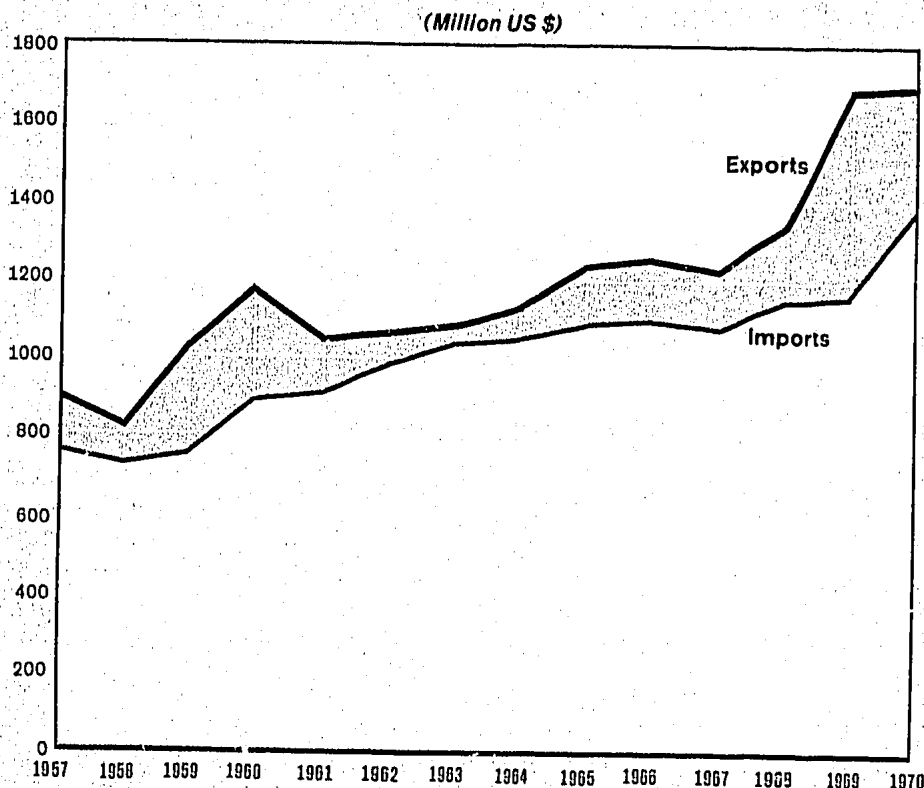
7. Economic growth has taken precedence over social and political goals in official policy, although the government has made some effort to improve the economic position of the Malays. Public investment 2/ more than tripled in the past decade and now accounts for about 30% of total fixed investment (see Figure 3). The great majority of this investment has gone to Malay-dominated smallholder agriculture and to infrastructure and

2. In all, budgetary expenditures amount to about \$100 per capita, a very high figure for a less developed country. Malaysia raises only a small amount - about 10% - of its revenues from export taxes, relying on income taxes and import and excise duties (largely on luxury goods) for most of the remainder. Such a taxation system is beneficial for exporters' incentives because taxes are largely based on profits rather than on the quantity of foreign sales.

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CONFIDENTIAL**MALAYSIA: Foreign Trade**

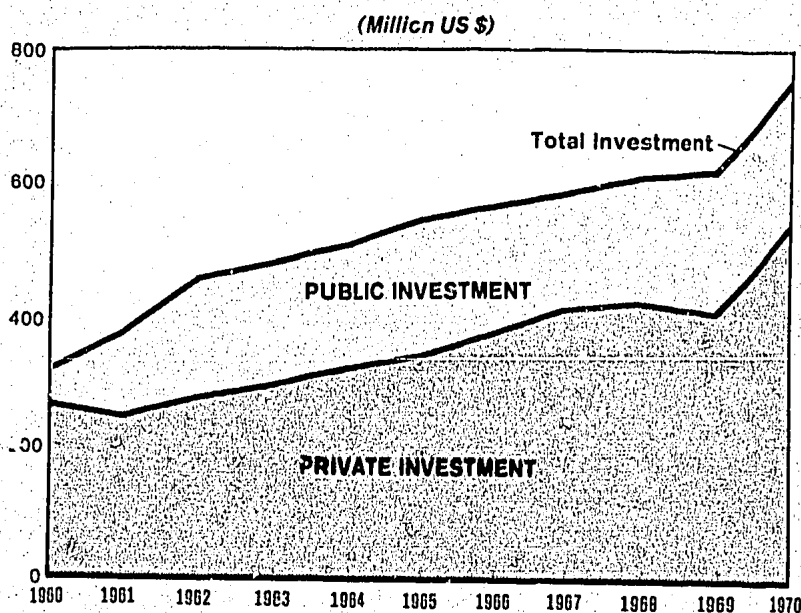
Figure 2



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Figure 3

MALAYSIA: Private and Public Investment

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social services, especially education. All of the races have benefited from Malaysia's growth, but probably the economically disadvantaged Malays most of all, particularly because this relatively backward group had most to gain from the improvement of the infrastructure and social services.

8. West Malaysia, where 85% of the population is found, accounts for 85% of the gross national product (GNP), produces about 95% of the rubber and palm oil and all of the tin, Malaysia's only important mineral resource. The major economic activity in East Malaysia on the island of Borneo, which accounts for almost three-fifths of Malaysia's log exports, is timber exploitation. Petroleum, which is also exploited in East Malaysia, supplies about one-sixth of national needs.

Export Production

9. Although Malaysia's population is only 11 million, exports totaled \$1.7 billion in 1970 (43% of GNP) and were the fifth largest among non-oil-producing less developed countries, only slightly below India's. Malaysia has for many decades been the world's largest exporter of rubber and tin and during the 1960s became the top exporter of tropical hardwood logs and palm oil.

10. Export growth averaged 6% annually during the 1960s in spite of stagnating world demand for the country's traditional export commodities. The price of natural rubber fell by about 25% in 1961 as a result of intensifying competition from synthetic products and continued downward through 1970, when it was only 55% of the 1960 level (see Figure 4). The volume of rubber exports increased appreciably, thereby compensating somewhat for the lower price, but rubber's importance as an export fell from 55% of total exports in 1960 to 34% in 1970 (see Table 1). Tin prices on the other hand climbed by 65% in 1970 over the 1960 level, but the volume of tin exports did not change significantly. Timber was the major contributor to export growth, increasing more than five times from 1960 to 1970, while earnings from palm oil also quadrupled, but from a much smaller base.

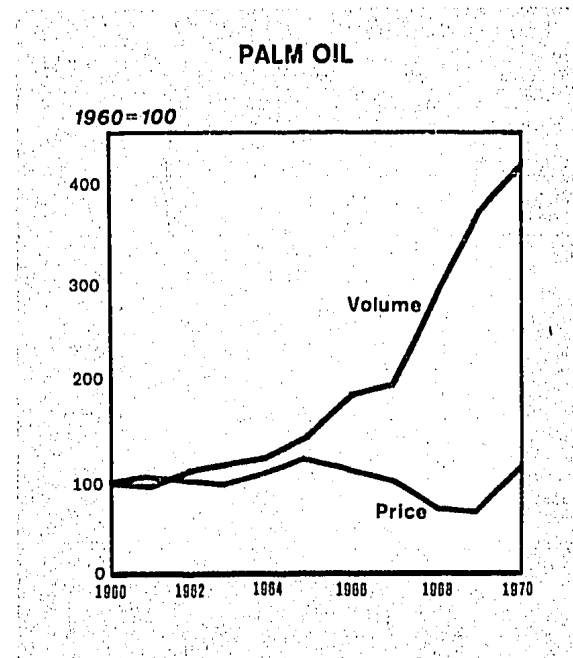
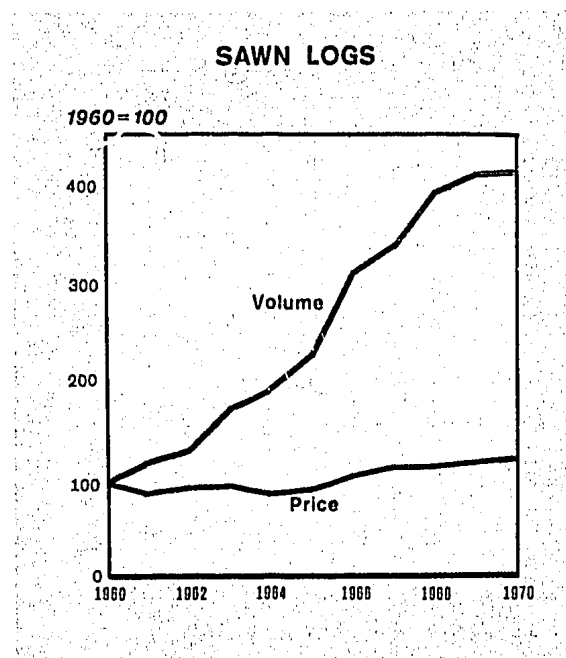
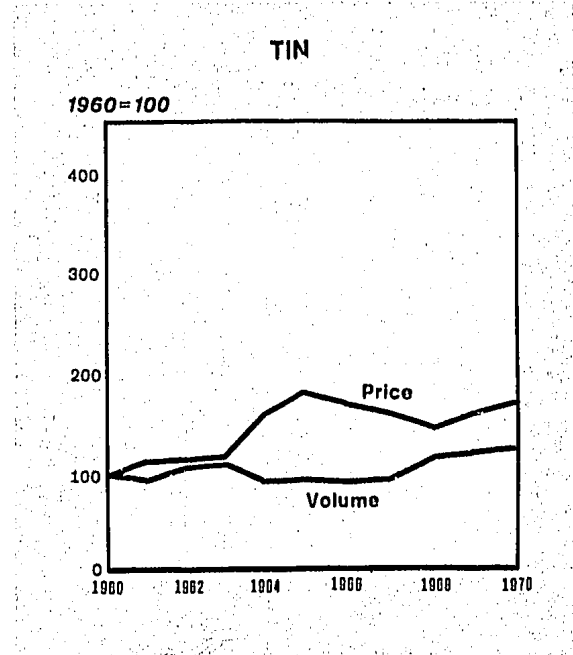
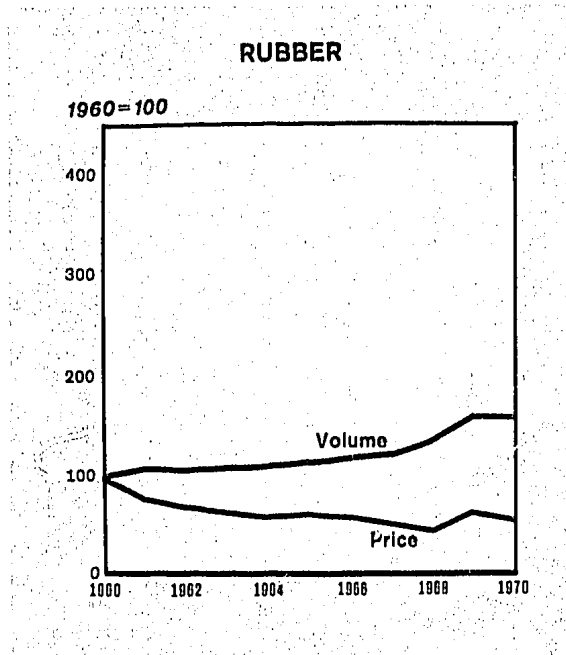
11. Efficient producers, responding quickly to new market opportunities and receiving government support, are largely responsible for Malaysia's export success. Both local and foreign investors plunged quickly into timber exploitation as the demand for wood, particularly in Japan, increased sharply. Malaysia, together with Indonesia and the Philippines, supplied most of Japan's increased demand for broad-leaved logs from 1966 to 1970. The phenomenal rise in palm oil production was the result of cooperation between the government and estate owners who were eager to reduce their hitherto virtually complete dependence on rubber.

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Figure 4

MALAYSIA: Major Exports



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Table 1

Malaysia: Commodity Composition of Exports

	<u>Percent</u>	
	<u>1960</u>	<u>1970</u>
Rubber	55	34
Tin	14	19
Timber	5	17
Saw logs	3	13
Sawn timber	2	4
Palm oil	2	5
Iron ore	4	2
Other	20	23

Government subsidies were made available to help defray the investment costs of planting, and government-sponsored research developed high-yielding palms. Acreage under cultivation increased by 450% to 735,000 acres in 1969, with 80% on rubber estates, where the world's highest palm oil yields are attained. By 1966, Malaysia had surpassed Nigeria and the Congo (K) in sales and by 1970 accounted for over 40% of world exports. Malaysia's investment in extensive land clearing and resettlement schemes for thousands of landless farmers has boosted smallholder palm oil production appreciably.

12. Through technological advances, Malaysia has increased its lead as the first-place and most efficient natural rubber producer. ^{3/} The 1.3 million tons produced in 1969 was 45% of world output, or a 5% greater share than in 1960. Malaysia's output rose some 66% during the 1960s, but acreage increased only 9%. Thus most of the increased production derived from raising yields per acre. Replanting with new, high-yielding tree varieties has been most important in improving yields. By 1969, new trees covered 90% of estate and 60% of smallholder acreage. From the new trees and other innovations, substantial gains in productivity and product quality have also ensued. A newly developed processing technique produces rubber of uniform purity and grade in conveniently handled block form more cheaply than previously used techniques. This block rubber, which commands top price in the world market, accounted for 11% of output in 1969. The government has subsidized new planting, technological

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innovations, and land resettlement schemes which have been a boon to smallholders in particular. Rubber acreage in these projects increased enough to more than offset a 16% decline in estate acreage which was caused chiefly by the shift to oil palm. Since 1960, smallholder acreage has risen from one-half to about two-thirds of the total. Under the guidance of extension services, smallholder yields have also been steadily rising and are now about three-fifths the yields on estates.

13. Malaysia remained one of the few major tin producers whose output was not adversely affected by political turmoil, and domestic output rose more than 3% annually in contrast to an increase in world demand of only 1% during the 1960s. Worldwide production shortfalls were created by political and economic upheaval, especially in Indonesia and Bolivia. The higher world prices were a spur to Malaysian production despite a decline in the tin content of Malaysia's deposits. Most of the increased output in Malaysia originated not from the large dredging companies but from smallscale producers operating gravel pumps. The number of pumps more than doubled during the decade. 4/

Import Substitution

14. Substantial increases in rice production and manufacturing have increased the share of gross domestic product consumed domestically by 10 percentage points between 1960 and 1969 as shown below:

	<u>Percent</u>	
	<u>1960</u>	<u>1969</u>
Production for export	55	45
Production for domestic use	45	55

15. With strong official support, Malaysia's farmers doubled their rice production during the 1960s, to almost 1 million tons. This increased output significantly reduced import dependence to 20% of total supplies, compared to 40% in the early 1960s. Growth was attributable to a 60% acreage expansion and a 25% rise in yields. Thanks mainly to government-sponsored irrigation projects, West Malaysia's double-cropped rice acreage, insignificant in the early 1960s, accounted for 20% of total rice acreage at the decade's

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end. The government has also established credit and extension services and subsidized fertilizer. Moreover, production against imports has been offered through producer price support and requiring importers to purchase a set proportion of domestic rice for every ton purchased abroad.

16. Government policies also encouraged growth of import substitution industries. The still small manufacturing sector increased production by 9.5% annually from 1960 to 1969, raising its share of national output from 9% to 12%. Domestic manufactures now account for over one-half of domestic market needs, compared with one-third in the early 1960s. Growth was most rapid in food processing, textiles, rubber products, and cement. More recently, steel, electrical machinery, and car and truck assembly have also become leading growth industries. Tariffs normally ranging from 25% to 40% *ad valorem* on selected products have been the chief policy instruments for fostering this growth. These have been supplemented by import quotas, but imports of raw materials and intermediate goods have been generally exempt from duty. In addition, tax incentives have been used selectively, including tax holidays for the so-called Pioneer Industries - those granted special status for developing new priority production - and investment tax credit for certain other industries. Foreign investors receive virtually the same incentives as local entrepreneurs. The government has also built many industrial estates with requisite infrastructural facilities to attract new investment.

The Economic Status of the Malays

17. Malay ownership in the goods-producing modern sectors is still quite minor, although they account for 44% of the population. The Chinese, with 37% of the population, and a relatively few Europeans own most of such facilities. The Chinese share, however, has been increasing at the expense of foreign interests. European ownership (including a few Americans) of estate acreage planted to rubber declined from about 59% to 52% of the total. Most of this decline was due to the transfer of estates to Chinese ownership and part to a shift to oil palm production. European rubber estate acreage is overwhelmingly British and still accounts for the vast bulk of holdings above 1,000 acres as well as for most of the estate rubber processing factories. Tin mining operations in the rapidly growing gravel pump sector are practically all Chinese-owned. This sector's share of tin concentrate output rose from one-third to more than one-half from 1960 to 1969, while the number of dredges in the mainly British-owned dredge sector remained virtually constant and output declined. Manufacturing, including non-estate rubber processing, is controlled mainly by Chinese interests, including many of the large plants built in recent years. Among the new industries qualifying as Pioneer Industries - ranging from automobile assembly to electronics - foreign investors have a 60% share.

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18. Chinese interests have also been acquiring an increasing share of control in finance and commerce. Although 22 of Malaysia's 38 commercial banks are foreign-owned, Chinese-owned banks have been gaining an increasing share of the rapidly expanding business and now hold about 40% of total deposits, compared with about 25% in the early 1960s. Local Chinese control most of the import, wholesale, and retail trade, although the foreign-owned estate-company agency houses still conduct an important but gradually declining part of the business.

19. The distribution of employment by race among sectors points up the concentration of Malays in smallholder agriculture. According to Kuala Lumpur, this distribution has remained fairly constant. 5/ The 1968 data show Malays account for about 80% of those employed in smallholder agriculture. The remaining 20% are practically all Chinese, mainly rubber growers. In contrast the total employed labor force is 50% Malay, 36% Chinese, and 13% Indian. On the estates, half the employees are Indians and the balance are Chinese and Malays (see Table 2).

20. Outside agriculture, Malay employment is concentrated in government services, including teaching. The decisive Malay domination in government services - over 60% of the total - reflects their political power and constitutionally guaranteed preferences. 6/ With the rapid spread of education and Malay language training, Malays by 1968 occupied 53% of the 75,000 teaching jobs in West Malaysia. They also comprise the bulk of police and armed services personnel. In some other non-agricultural sectors - public utilities, sanitary services, transport, storage, and communications - Malays predominate over each of the other races, with 40%-45% of employment. Most of these jobs, however, are menial and low-paying.

21. In contrast, the Chinese account for over 60% of those employed in non-estate rubber processing, mining, manufacturing, construction, commerce, and non-government services. Moreover, Chinese hold 75% of the proprietorship and managerial positions. In the professions, except for teaching, the Chinese account for 50%. Most Indians work on estates and in public utilities, transport, and government services. Moreover, the relatively small Indian minority accounts for almost as many professionals as the Malays.

5. Employment data on East Malaysia are not available.

6. As outlined in the constitution, some of the special privileges of Malays include: the reservation of a fixed proportion of public service positions, scholarships, educational opportunities, license for trade and business for Malays; and the reservation of the Royal Malay Regiment exclusively for Malays.

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Table 2

West Malaysia: Employment by Industry and Race, 1968 ^{a/}

Sector	Total Employment		Employment by Race (Percent of Sector)			
	Thousand	Percent of Total	Malays	Chinese	Indians ^{b/}	Other
Agriculture, forestry, and fishing (excluding estate-type products)	500.7	21.2	79.3	17.9	1.0	1.8
Estate-type products	718.8	30.4	52.5	25.8	21.1	0.6
Oil palm and tea	40.4	1.7	28.1	17.3	53.1	1.5
Rubber growing	621.4	26.3	52.5	27.3	19.7	0.5
Rubber processing off estates	6.3	0.3	28.9	61.9	7.7	1.5
Other	50.7	2.1	74.7	10.6	14.7	0.0
Mining and quarrying	72.0	3.0	26.4	61.0	11.8	0.8
Manufacturing	214.8	9.1	32.3	62.1	4.8	0.8
Construction	78.9	3.3	27.5	60.9	10.4	1.2
Electricity, gas, water and sanitary services	22.3	0.9	44.0	13.7	40.9	1.4
Commerce	255.2	10.8	25.5	64.4	9.5	0.6
Transport, storage and commu- nication	86.2	3.6	42.0	35.8	21.2	1.0
Services	413.0	17.5	43.8	38.9	15.1	2.2
Government services ^{c/}	111.7	4.7	61.6	14.3	18.8	5.3
Other services	142.0	6.0	25.0	61.4	12.9	0.7
Not specified	3.5	0.2	--	--	--	--
Total	2,365.4	100.0	49.8	36.4	12.6	1.2

^{a.} Average for period mid-1967 to mid-1968.^{b.} Includes small proportion of Pakistanis and Ceylonese.^{c.} Includes teachers.

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22. The largely rural Malays have benefited most from the spread of modern infrastructural facilities and social services. Extensive road construction and the expansion of public transportation have significantly reduced the isolation of rural areas and made them more accessible to health services and education. Enrollments in Malay-speaking schools -- the principal but not the sole source of Malay education -- have risen steadily. Since the mid-1960s the main increase has been in secondary education, where enrollments in Malay-speaking schools increased sixfold.

23. Unemployment rates among Malays have remained rather constant, while those among Chinese and especially Indians have increased. In West Malaysia in 1968 the unemployment rate for Malays was 5.8%, compared with 6.1% in 1962. During this same period the rate for Chinese rose from 6% to 7% and that for Indians from 6% to more than 10%. These trends probably reflect relatively greater opportunities for Malays in smallerholder agriculture partly as a result of rural resettlement schemes. While the total number of unemployed Malays rose by only 4%, the ranks of unemployed Chinese rose by 14% and those of Indians almost doubled. The growth of Chinese unemployment reflects in part their higher concentration in urban areas, where unemployment reached about 10% in 1968. Unemployment is also high among the young, especially in urban areas. Unemployment in the 15 to 19 age group in cities was 29% in 1968 and 16% in the 20 to 24 age group. The soaring unemployment of Indians resulted mainly from lay-offs on rubber estates because of new labor-saving production techniques.

Protest and Response

24. The United Malay National Organization (UMNO), the ruling political party since independence, has been able to avoid granting the more radical Malay demands for special treatment which might threaten economic growth. In its coalition with the Malay Chinese Association, UMNO is pledged to the interracial compromise that allows the Chinese full economic rights in the modern economy. Until May 1969 the strong political leadership; the greatly increased spending on education, infrastructure, and agriculture; and the favorable economic situation apparently blunted Malay discontent. But the racial riots of May 1969 following the elections which upset the delicate racial balance in the government brought the Malay problem into the open. There was a rising clamor, especially among the younger, middle-echelon UMNO leaders, for extending Malay economic privileges. Speculation quickly arose that radical departures in policy might be in store, especially since Tun Abdul Razak was soon to take over as Prime Minister and as head of UMNO after a 13-year rule by the Tunku Abdul Rahman. New laws were passed to greatly increase the role of the Malays in modern economic activities, but in practice nothing was done to disrupt the economy.

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25. Official pronouncements following a mid-1969 policy review stressed the intention to impose Malay hiring quotas on new Pioneer Industries. But because of the scarcity of Malay skilled labor, these quotas have remained negotiable. Legislation was also passed making citizenship a prerequisite of employment, a law designed to reserve jobs for Malays since most non-citizens are Chinese and Indians. When this Employment Restrictions Act was promulgated in July 1969, broad exemptions were made for those holding skilled and professional jobs - mostly Chinese in urban areas - and the main initial impact fell on Indian estate labor. At the end of 1969, there were only 900 Malay applicants for over 5,100 unfilled jobs on estates. In consequence, Kuala Lumpur found it expedient to back down and permit the rehiring of Indians, and since then the legislation has been largely ignored.

26. The mid-1969 policy review and subsequent official actions have reaffirmed and strengthened past policies of promoting economic growth and improving the Malays' lot without restricting Chinese enterprise. There have been intensified efforts to stimulate private investment in labor-intensive industries and/or those producing for export. Coordination of the Pioneer Industries Program has been vested in the new high-level Capital Investment Committee which has stepped up promotional campaigns to attract foreign as well as domestic investors. Partly as a result, the capital pledged for Pioneer Industries increased by 250% in the first 10 months of 1970 compared with the entire previous year. At the same time, the government began to honor its long-standing pledge to lend direct support to Malay industries by putting up one-fifth of the share capital for a Malay batik textile enterprise in late 1969.

27. Preliminary releases in May 1970 on the Second Five-Year Plan (1971-75) underscore continuing promotion of Malay development together with incentive support for Chinese private enterprise. Public investment is to increase by more than half and will account for more than half of total investment during the Plan. Much of this will be devoted as in the past to programs of special benefit to Malays, including opening up new irrigated rice lands and replanting smallholder rubber plots as well as continuing high expenditures on education, including technical training. The Plan also indicated Kuala Lumpur's intention to involve both government and private enterprise more directly in industrial development in the predominantly Malay regions of West Malaysia's east coast.

Outlook

28. Malaysia's economic future will depend on a continuation of political stability and traditional economic policies as well as expansion of production for export and the home market. Political stability is rather

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tenuous. Recent experience has vividly shown that the undercurrents of racial hostility run very deep, and Malay protest against Chinese economic predominance has become increasingly strident even within UMNO ranks. Moreover, the income gap between Malays and other races is not likely to narrow much over the next several years even with continued economic prosperity. Racial mobility across economic sectors is not expected to increase very much, because acquiring technical, managerial, and entrepreneurial skills is inevitably a long-term process. But even though serious communal disturbances disrupting the economy cannot be ruled out, the prospects for maintaining political stability and policy continuity are probably better in Malaysia than in many other less developed countries. The political institutions are deeply embedded, and Razak's is a law and order regime pledged to suppress interracial violence. Moreover, even if racial income disparities are not lessened appreciably, the Malay's lot and his potential for a larger role in the modern economy will continue to improve with sustained economic growth.

29. The generally healthy condition of Malaysia's economy should provide a favorable setting for continued export growth. There was an investment boom in 1970, and under the stimulus of present incentive policies, investment could easily grow more vigorously in the next five years than during the First Malaysia Plan. Moreover, the opportunities for boosting economic growth through import substitution remain substantial. Further gains in rice output are likely both from expanded acreage and yield increases. Malaysian rice yields - about 2,400 pounds per acre - are higher than elsewhere in Southeast and South Asia but are still quite low compared with other regions. Yield increases should occur because most acreage expansion will be in areas with controlled irrigation and because modern techniques will be used more intensively. Manufacturing for domestic consumption could also continue growing rapidly since the home market for many basic products has hardly been tapped. Local textile production, for example, still accounts for less than one-fifth of consumption. A strong balance of payments should enable Malaysia, as in the past, to weather temporary slowdowns in export growth without setbacks to ongoing public and private projects. And, with the large reserves on hand, the potential for expanding public investment through increased official borrowing abroad is considerable.

30. The growth of exports is likely to be sustained despite fairly weak world demand for natural rubber and tin. Merely by maintaining its present share of world tin and rubber exports - a conservative estimate considering its relatively efficient producers - Malaysia could maintain earnings from sales of these products at roughly their current levels. If at the same time exports of logs, sawn timber, palm oil, and all other products as a whole continue advancing at past rates, the rate of overall export expansion will be about the same as that achieved during the past five years (6.3%).

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31. Export earnings from rubber can probably be maintained at about their present levels. Natural rubber faces a downward price trend and sluggish demand which may grow at only about 3% per year. Export receipts, therefore, are unlikely to reach the highs of 1969, when prices took a sudden and shortlived upturn. Malaysian producers, however, should be able to keep their world market leadership. Yields per acre may be increased in the smallholder sector in particular as more yielding trees come into production. The use of new chemicals, still in the experimental stage, may also have some effect.

32. Tin earnings are expected to continue at present high levels. Demand for tin probably will rise by about 1% annually, and prices should remain quite steady. Malaysia can easily hold its own in this market partly because its industry is making significant investment in modernization to assure continuing modest output growth. Meanwhile, some other big producers such as Bolivia and Indonesia are unlikely to achieve major output gains.

33. Export expansion over the next several years will continue to focus mainly on timber and palm oil. The world market for wood, and especially the Japanese market, which takes about two-thirds of Malaysia's timber exports, will almost certainly continue to grow. Logging output from Malaysia's extensive and accessible forest reserves should continue to rise at rapid rates. Earnings will probably be increased, moreover, by the increasing share of lumber in total timber exports. Prospects for substantially increased earnings from palm oil exports are also bright. As reflected in a 54% rise in the price for palm oil in 1970, there has been an upturn in the world market for vegetable oils, and the future strength of demand is promising. Because over half the growth of Malaysian oil palm acreage has occurred since 1966 and because it takes three to four years for a tree to begin producing, future output should continue to rise very rapidly. In addition, earnings from palm oil exports will increase with the completion of facilities that will make it possible to export a much larger portion of the product in refined form.

34. On a lesser scale, manufactures could also become a source of export growth. They comprised only about 10.5% of total exports in 1970, but recent trends in their growth and in government policy are promising. Exports of manufactures, included processed foods, rose by nearly one-half between 1966 and 1970 and in the latter year alone they increased by almost one-fifth. Among the leading items have been wood products, cement, and machinery and equipment. Policy support for exports of manufactures was further extended in April 1970 with the creation of the National Export Advisory Council. More recently the government has been campaigning to attract investment by US electronics firms, hoping to

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establish plants producing primarily for the US market. Manufacturing for export and attracting foreign investment for that purpose represent two probably essential preconditions for sustaining a more rapid industrial expansion in the future. Like Hong Kong, Taiwan, and South Korea, Malaysia can best sustain large-scale investment in the long-run by drawing on foreign sources eager to exploit plentiful and cheap local labor and by producing for vast foreign markets, especially in developed Western countries.

Conclusions

35. Malaysia has sustained rapid economic growth largely through its remarkable success as a primary commodity exporter. It has increased its world market share of traditional exports - rubber and tin - and developed new ones. Substantial gains have also been made in expanding output for the home market. These accomplishments have been made without benefit of significant foreign aid while maintaining a remarkably strong balance of payments and a non-inflationary domestic economy. Underlying this economic progress has been comparative political stability and government policies which have stimulated private sector development. Moreover, official economic policies have been aimed primarily at growth rather than at political and social goals despite the relatively unfavorable economic position of the politically dominant Malays in comparison with the economically powerful Chinese.

36. Both the Malays and the Chinese have benefited from the country's economic progress, but the racial economic disparities, particularly in terms of income, have not narrowed very much. The Malays have benefited in particular from government support of rice production and large government investment in infrastructure and social services. Largely because of these factors, racial economic discontent did not loom large as a political issue until the 1969 racial riots.

37. Despite some rise in Malay discontent, the fledgling Razak administration appears to have reaffirmed and strengthened the past policies of promoting economic growth and improving the Malay's lot without restricting Chinese enterprise. The more radical demands for massive government intervention to broaden Malay participation in the modern sectors have been rejected out of hand. Although further outbreaks of racial violence could occur, Razak's commitment to law and order strongly implies a pledge to essential continuity in traditional growth-oriented economic policies.

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38. With continuing political stability, Malaysia's prospects for sustaining economic growth rates of about 6% annually appear favorable. Opportunities for import substitution remain substantial, and export prospects are fairly bright despite weak world demand for natural rubber and tin. Even if foreign sales of those two commodities remain at current levels -- a conservative estimate -- export expansion will probably continue at near past rates because of newly developed product lines. Timber and palm oil exports will continue to grow, and manufactured goods are expected to become an increasingly significant source of export growth. Furthermore, the country is protected against short-term economic difficulty by its large international foreign exchange reserves, relatively few foreign debts, and an excellent international credit rating upon which it could borrow.

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